

Pivot to the Pacific? Is it “risk on” Asia?

Published 13 April 2017

“Team Trump” demonstrated exemplary global economic leadership skills at last week’s Summit between President Donald Trump and China’s President Xi Jinping. Most importantly, both leaders agreed to a concrete agenda of dialogue and engagement: At the working level, both nations committed to a “100-day plan” to address bi-lateral trade issues, with progress overseen by the two Presidents directly; and at the top level, President Trump accepted President Xi’s invitation for a follow-on bi-lateral Summit in China sometime later this year.

Both leaders went out of their way to seek common ground and work towards credible solutions, rather than—as was widely expected before the meeting—merely agreeing to disagree. The new US-China bi-lateral relationship is off to a pragmatic and forward-looking start. This is good news for global risk asset markets in general and Japan equities, in particular: The risk of a trade and/or currency war coming to Asia has now come down significantly, in my view.

The US-China Presidential Summit was just the first step in a series of events that will shape investor confidence in future opportunities and prospects for the world’s most dynamic economic region, Asia Pacific. Next comes 14 April, when the US Treasury is due to publish its report on currency manipulation; and then we get the visit by US Vice President Mike Pence and Commerce Secretary Wilbur Ross to Tokyo for the first US-Japan economic, trade and finance framework talks during the week of 17 April.

A return of true “risk on” requires evidence of coordinated policy leadership from America, with the Treasury Department, Commerce Department and the White House demonstrating a unified and coordinated approach. For example, it would be alarming to see China accused of currency manipulation without immediate reference to the newly agreed US-China “100-day plan” as a forum to work things out. Ditto for the Yen and the US-Japan bi-lateral forum. The more professional and coordinated US trade and investment policy leadership gets, the less distracted risk takers will be by the “chattering classes.” Both Washington and Tokyo are working hard to create a possible blueprint on future US-bilateral economic, trade and investment relations. In my personal view, the “Team Trump” Asia Pivot between 6 April and 21 April marks the first real test of what the new US administration is capable of.

From the US-China-Japan triangle to Asia Pacific

Here in Tokyo, the success of the US-China Summit was greeted with relief. Yes, there is an understanding of the symbolism inherent in the fact that the US-China bilateral framework talks will be overseen by the two Presidents personally whilst, in contrast, the US-Japan bilateral talks are led by the two Vice Presidents. At the core of this lies not only the fact that both PM Abe and President Trump already have a much deeper relationship of not just personal trust but also national co-dependence: The US-Japan Security alliance is a bedrock that allows economic and trade relations to be viewed as more of a technical problem between the two nations, rather than a fundamental one. In contrast, the US-China security and defence relationship

is much less well defined, with both countries' ambitions perhaps more competitive than complementary. "Team Abe" understands that the greater complexity of the US-China relationship does require oversight at the highest level because it is much more controversial and requires much greater political capital commitment.

Here, it is important to stress how pivotal a smooth US-China trade relationship is to the future prosperity of all of Asia Pacific. Competition between China and the rest of Asia is intense. Specifically, export competition is extremely fierce, with almost 80% of Asia-ex-China exports competing head-to-head in the US market against made-in-China products (see Table 1). Even for Made-in-Japan, about 65% of exports compete head-to-head against Made-in-China, with the lack of direct competition in the car and car-parts markets the principal reason why Japan is relatively low compared to the rest of Asia. Make no mistake—China's position in global export markets is not an unassailable "monopoly."

Table 1: Who is afraid of China? Percentage of country's exports that compete head-to-head with Made-In-China products in the US market

Philippines

Source: WisdomTree, Japan. Calculations based on UNCTAD Trade Statistics.

The key implications are twofold, in my view. Firstly, a breakdown of US-China free trade would almost certainly trigger a currency war, with China most likely forced to compensate for potential adverse tariffs by debasing its currency. Not doing so would risk market share loss as Asian suppliers could move in quickly.

Secondly, the US administration starts the "100-day-plan" negotiations from a position of relative strength. For America, there are plenty of alternative suppliers to Made-in-China. For China, the almost certain loss of exports would probably force unemployment to rise, which in turn could undermine leadership credentials for the Communist Party and cause frictions between local governments and the central government.

In my view, the fact that China President Xi himself is directly supervising progress on the "100-day plan" underscores that failure is not an option for China.

The conditions for a "risk-on" trigger from the removal of policy uncertainty in Asia are beginning to fall into place. Whether these developments in Asia have any bearing on other regions—for example, Europe—remains to be seen. Unlike US-Japan and now US-China, a credible path towards bi-lateral engagement in Europe appears unlikely before we know who will be ruling in Europe's strongest powers, Germany and France.

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